



**DEPARTMENT OF THE TREASURY**

**INTERNAL REVENUE SERVICE**

**1100 Commerce Street**

**Dallas, TX 75242**

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

**April 10, 2008**

**Number: 200829049**

**Release Date: 7/18/2008**

**LEGEND**

**ORG = Organization name      XX = Date      Address = address      Founder = founder**

**UIL: 501.03-01**

**ORG  
ADDRESS**

**Person to Contact/ID#:  
Contact Telephone Number  
Taxpayer Advocate's Office, Address,  
And telephone Number:**

**CERTIFIED MAIL**

**LAST DATE TO FILE A PETITION  
IN TAX COURT  
June 9, 20XX**

**Dear :**

**This is a final adverse determination that you do not qualify for exemption from income tax under section 501(a) of the Internal Revenue Code (I.R.C.) as an organization described in I.R.C. § 501(c)(3). In addition, you do not qualify as an organization described in I.R.C. § 509(a)(1) & 170(b)(1)(a)(vi). Internal Revenue Service recognition of your status as an organization described in I.R.C. section 501(c)(3) is revoked, effective January 1, 20XX. Our adverse determination is made for the following reason(s):**

**You are not operated exclusively for tax exempt charitable purposes because more than an insubstantial purpose of your organization is to serve the needs of your Founder.**

**Contributions made to you are no longer deductible as charitable contributions by donors for purposes of computing taxable income for federal income tax purposes. See Rev. Proc. 82-39 1982-2 C.B. 759, for the rules concerning the deduction of contributions made to you between January 1, 20XX and the date a public announcement, such as publication in the Internal Revenue Bulletin, is made stating that contributions to you are no longer deductible.**

**You are required to file income tax returns on Form 1120 for all years beginning after January 1, 20XX. Returns for the years ending December 31, 20XX and December 31, 20XX must be filed with this office within 60 days from the date of this letter, unless a request for an extension of time is granted. Send such returns to the following address:**

**If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States for the District of Columbia before the 91<sup>st</sup> day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. You may write to the Tax Court at the following address:**

The processing of income tax returns and assessment of any taxes due will not be delayed because a petition for declaratory judgment has been filed under I.R.C. section 7428.

The last day for filing a petition for declaratory judgment is June 9, 20XX.

If you have questions about this letter, please write to the person whose name and address are shown on this letter. If you write, please attach a copy of this letter to help identify your account. Keep a copy for your records. Also, please include your telephone number and the most convenient time for us to call, so we can contact you if we need additional information.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above, since this person can access your tax information and can help you get answers. Or you can contact the Taxpayer Advocate office located nearest you at the address and telephone number shown in the heading of this letter.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate, can, however, see that a tax matter, that may not have been resolved through normal channels, gets prompt and proper handling.

We will notify the appropriate State officials of this action, as required by I.R.C. section 6104(c).

This is a final revocation letter.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

Enclosures;  
Pub. 892



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service

TEGE, Group 7954

7850 SW 6th Court

Plantation, FL 33324

May 1, 2007

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer  <b>ORG</b>	Tax Identification Number	Year/Period ended  December 31, 20XX

**LEGEND**

ORG = Organization name      XX = Date      Address = address      XYZ = State      Revenue  
Agent = revenue agent      BM1 thru BM10 = 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup>, 5<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup>, 8<sup>th</sup>, 9<sup>th</sup>, and 10<sup>th</sup>  
board members

**ISSUES**

Whether ORG should continue to maintain its exempt status under Section 501(c)(3) of the Internal Revenue Code.

Whether inurement exists in payments made for the benefit of BM-1 of ORG

**FACTS**

**Background:**

On November 2, 19XX, ORG filed original articles of incorporation with the State of XYZ. The articles of incorporation provided that its purpose was, in part, "to aid the poor and disadvantaged individuals and families towards a life of self-sufficiency."

The following individuals were listed as ORG's directors:

<u>Name</u>	<u>Address</u>
BM-1	Address
BM-2	Address
BM-3	Address
BM-4	Address
BM-5	Address
BM-6	Address

The officers of the ORG included:

<u>Title</u>	<u>Name</u>
President	BM-1
Treasurer	BM-3
Secretary	BM-6

The By-laws of the organization set forth the following:

**Article III Section 1 General Powers:**

Subject to the limitations of the Articles of Incorporation, these By-laws and all corporate powers shall be exercised by or under the authority of the Board of Directors and the management and affairs of the Corporation shall be controlled by the Board of Directors.

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**Article IV Section 6 Salaries:**

Reimbursement of the Officers shall be fixed from time to time by the Board of Directors, no Officer shall be prevented from receiving such reimbursement by reason of the fact that he is also a Director of the Corporation.

On December 3, 19XX, ORG (herein referred to as "ORG") filed a Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, with the Internal Revenue Service, hereinafter "IRS" or the "Service".

In its Form 1023 application, ORG stated its initial activities would consist of prison outreach and youth drug prevention. ORG further stated that their by-laws listed several other activities they would implement in the future and would inform the IRS of these programs and submit a plan of action. See **Exhibit 1** for complete Activities and Operational Information portion of the Form 1023.

In a letter dated February 25, 19XX, ORG was recognized by the Service as exempt from Federal income tax as an organization described in section 501(c)(3) of the Code.

**Correspondence with the Service:**

On October 11, 20XX, an interview was conducted with BM-1, founder/executive director of ORG, and Revenue Agent. This interview was held to discuss BM-1's Form 1040 return for year ended December 31, 20XX. The 1040, Schedule C, listed ORG as his personal business. See **Exhibit 2** for a copy of 20XX Form 1040.

During the interview the BM-1 stated, in part, the following:

1. Someone told him if he wasn't making a certain amount of money, he didn't have to file a 990.
2. In 20XX, ORG housed twenty clients; \$ per week per person for room and board
3. There are no employees and he receives no wages from the organization
4. He does the bookkeeping himself
5. Records are not maintained on computer

See **Exhibit 3** for complete interview.

In a letter dated December 1, 20XX, ORG was notified that its Form 990, Return of an Organization Exempt From Federal Income Tax, for the tax years ended December 31, 20XX, had been selected for examination to determine if the organization is required to submit delinquent Form 990 returns for prior and subsequent years if its gross receipts were over \$.

**Exempt Activities:**

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 board members

In 19XX, BM-1 founded ORG. BM-1 operates and controls ORG as founder/executive director/CEO. His duties as director include: overseeing administrative duties, making sure bills are paid, staff oversight, keeping up with opportunities for funding, and making sure his vision is being carried out as he wrote it.

ORG's current activity consists of running a half way house for men who are in drug rehab or recently released from prison. A majority of the men are referred to ORG from agencies such as: the VA, mental health, CAP, and Pride and probation. Some of the men living at the facility are sponsored by the agency which referred them and remaining men pay for themselves. ORG currently leases ten apartments and one home to provide housing for its clients. Six of the apartment units are occupied by four men; three of the apartment units are occupied by two men; the home is occupied by three men. ORG has three volunteer resident managers who monitor the facilities and live rent free.

Other activities of ORG include: marriage counseling, support counseling, bus passes, referral service to other organizations if service not offered by them, and occasional feeding of people.

**Travel Expenses:**

During the year under examination, ORG incurred travel expenses on BM-1's behalf. BM-1 traveled to different cities in the United States to get information of how to take the agency to another level. Local car and hotel expenditures were also incurred by ORG. BM-1 used ORG's bank card to pay his expenses as they occurred.

Travel expenses for 20XX totaled \$. See **Exhibit 4** for complete list of travel expenses.

In order to substantiate that the expenses in the year under examination were related to the operation of the organization, the examiner issued Information Document Request #4 to ORG requesting documentation (receipts, bill statements, etc.) and an explanation (purpose of expenditures, people present, etc.). ORG responded with, "I know that some items in our statements, look like personal items, and some of them were. But the majority of them were replaced monetarily, for the sole purpose of validating that expense." No other documentation was provided to justify this statement. The examiner also questioned in IDR #4 if ORG had an accountable plan in place and if the board of directors had to approve travel for the year under examination. ORG responded, "No accountable plan was in place and the board of directors didn't approve travel because they were board members in name only."

**Personal Expenses:**

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 board members

In 20XX, ORG paid personal expenses on behalf of BM-1. The board of directors never authorized to pay his personal expenses from recovery's funds. BM-1 used the organization's check card and checks to pay for meals, car payments, clothing, services at his home, and other miscellaneous expenses. Although BM-1 stated that he repaid the organization for some of the expenses, no documentation to justify this statement was provided. The total amount for personal expenses paid by ORG for 20XX was \$. See **Exhibit 5** for list of transactions.

**Board of Directors:**

The XYZ Department of State, Division of Corporations discloses that ORG has five members on the Board of Directors. These board members include:

<b><u>Name &amp; Address</u></b>	<b><u>Title</u></b>
BM-7 Address	PD
BM-8 Address	DS
BM-9 Address	DT
BM-10 Address	D
BM-1 Address	ED

Based on a letter response to an Information Document Request, ORG stated, "The board of directors is only board members in name only." See **Exhibit 6** for complete response. Based on this statement, it is clear that there is no oversight by the board of directors to insure funds are being used for the organization's purposes.

**Failure to File Form 990:**

In Information Document Request #2, the examiner requested ORG to submit delinquent Form returns for years 20XX and 20XX in which the organization's gross receipts were more than \$. The examiner also provided Forms 990 for 20XX and 20XX in addition to the instructions for both years. ORG never submitted the delinquent returns to the Service and when questioned by the examiner BM-1 responded, "He did not know how to do it."

**LAW**

**In General:**



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board members

Section 501(c)(3) of the Internal Revenue Code provides that Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, ...no part of the net earnings of which inures to the benefit of any private shareholder or individual...are exempt from Federal income tax under this section.

Federal Income Tax Regulation (Regulation) Section 1.501(c)(3)-1(a)(1) states: "In order to be exempt as an organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such Code section. If an organization fails to meet either the organizational test or the operational test, it is not exempt." (emphasis added)

Regulation Section 1.501(c)(3)-1(c) provides, "An organization will be regarded as 'operated exclusively' for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose." (emphasis added)

Regulation Section 1.501(c)(3)-1(c)(2) provides, "An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. For the definition of the words 'private shareholder or individual', see paragraph (c) of Section 1.501(a)-1."

Regulation Section 1.501(a)-1(c) provides, "The words 'private shareholder or individual' in Section 501 refer to persons having a personal and private interest in the activities of the organization."

Regulation Section 1.501(c)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes "...unless it serves a public rather than a private interest. Thus ...it is *necessary for an organization to establish* that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders or the organization, or persons controlled, directly or indirectly, by such private interests." (emphasis added)

**Primary Purpose: Substantial Nonexempt Purpose:**

In *Better Business Bureau of Washington, D.C. v. United States*, 326 U.S. 279, 283 (1945), the United States Supreme Court stated that "the presence of a single...[non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly...[exempt] purposes."

In *American Campaign Academy v. Commissioner*, 92 T.C. 1053, 1065-1066 (1989), the court stated that when an organization operates for the benefit of private interest...the organization by definition does not operate exclusively for exempt purposes. Prohibited private benefits may include an "advantage; profit; fruit; privilege; gain; [or] interest." Occasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefits. Thus,

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 board members

should [the organization] be shown to benefit private interests, it will be *deemed* to further a nonexempt purpose under section 1.501(c)(3)-1(d)(1)(ii). This nonexempt purpose will prevent [the organization] from operating primarily for exempt purposes absent showing that no more than an insubstantial part of its activities further private interests or any other nonexempt purposes.

**Inurement and Private Benefit:**

In *American Campaign Academy v. Commissioner*, 92 T.C. 1053, (1989), the Court addressed the operational test and illuminates the difference between private benefit, derived by private interests where such private benefit is adverse to exemption under Section 501(c)(3), from inurement, derived by insiders, which also is adverse to exemption under Section 501(c)(3). It states:

...To establish that it operates primarily in activities which accomplish exempt purposes, petitioner must establish that no more than an insubstantial part of its activities does not further an exempt purpose. Sec. 1.501(c)(3)-1(c)(1), Income Tax Regs. The presence of a single substantial nonexempt purpose destroys the exemption regardless of the number or importance of the exempt purposes. *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945); *Copyright Clearance Center v. Commissioner*, 79 T.C. 793, 804 (1982).

...We have consistently recognized that while the prohibitions against private inurement and private benefits share common and often overlapping element, *Church of Ethereal Joy v. Commissioner*, 83 T.C. 20, 21 (1984), *Goldsboro Art League, Inc. v. Commissioner*, 75 T.C. 337, 345 n. 10 (1980), the two are distinct requirements which must independently be satisfied. *Canada v. Commissioner*, 82 T.C. 973, 981 (1984); *Aid to Artisans, Inc. v. Commissioner*, 71 T.C. at 215. Nonetheless, we have often observed that the prohibition against private inurement of net earnings appears redundant, since the inurement of earnings to an interested person or insider would constitute the conferral of a benefit inconsistent with operating exclusively for an exempt purpose. *Western Catholic Church v. Commissioner*, 73 T.C. 196, 209 n. 27 (1979), *affd. In an unpublished opinion* 631 F.2d 736 (7<sup>th</sup> Cir. 1980). See also sec. 1.501(c)(3)-1(c)(2), Income Tax Regs. In other words, when an organization permits its net earnings to inure to the benefit of a private shareholder or individual, it transgresses the private inurement prohibition and operates for a non exempt private purpose.

...The absence of private inurement of earnings to the benefit of a private shareholder or individual does not, however, establish that the organization is operated exclusively for exempt purposes. Therefore, while the private inurement prohibition may arguably be subsumed within the private benefit analysis of the operational test, the reverse is not true. Accordingly, when the Court concludes that no prohibited inurement of earnings exists, it cannot stop there but must inquire further and determine whether a prohibited private benefit is conferred. See *Aid to Artisans, Inc. v. Commissioner*, 71 T.C. at 215; *Retired Teachers Legal Fund v. Commissioner*, 78 T.C. 280, 287 (1982).

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board members

In People of God Community v. Commissioner, 75 T.C. 127 (1980) the Court, in examining the compensation arrangement of an insider, noted that it is an established principle that the organization is entitled to pay reasonable compensation to an insider but the burden of establishing the reasonableness of the compensation fell upon the organization.

In Founding Church of Scientology v. United States, 412 F. 2d 1197 (Ct. Cl. 1969). Cert. den., 397 U.S. 1009 (1970). The Court determined that the different arrangements between the organization and its founder, such as payment of ten percent or gross revenues, lending of money to him and his family, payment of expenses on their behalf, rental of property at inflated prices, resulted in inurement. The Court rejected the reasonable compensation defense. It stated: If in fact a loan or other payment in addition to salary is a disguised distribution or benefit from the net earnings, the character of the payment is not changed by the fact that the recipient's salary, if increased by the amount of the distribution or benefit, would still have been reasonable.

Section 4958 of the Code, effective September 14, 1995, was added to the Internal Revenue Code by the Taxpayer Bill of Rights 2 bill in 1996 (P.L. 104-168, enacted July 30, 1996). In Caracci v. Commissioner, 118 T.C. No. 25 (20XX), the Court noted: "With the enactment of section 4958, however, the issues whether the tax-exempt status ... tax-exempt entities should be revoked now must be considered in the context of the 'intermediate sanction' provisions. ... the intermediate sanction regime was enacted in order to provide a less drastic deterrent to the misuse of a charity than revocation of that charity's exempt status. The legislative history explains that "the intermediate sanctions for 'excess benefit transactions' may be imposed by the IRS in lieu of (or in addition to) revocation of an organization's tax-exempt status." *H. Rept. 104-506, supra at 59, 1996-3 C.B. at 107*. A footnote to this statement explains: "In general, the intermediate sanctions are the sole sanction imposed in those cases in which the excess benefit does not rise to a level where it calls into question whether, on the whole, the organization functions as a charitable or other tax exempt organization." *Id. N. 15, 1996-3 C.B. at 107*. Although the imposition of section 4958 excise taxes as a result of an excess benefit transaction does not preclude revocation of the organization's tax-exempt status, the legislative history indicates that both a revocation and the imposition of intermediate sanctions will be an unusual case." (emphasis added)

Net earnings may inure to the benefit of private individuals in ways other than by the actual distribution of dividends or payment of excessive salaries. General Contractors' Ass'n v. United States, 20XX F. 2d 633 (7<sup>th</sup> Cir. 1953) – reports and surveys furnished to members; Chattanooga Auto. Club v. Commissioner, 182. F. 2d 551 (6<sup>th</sup> Cir. 1950) – service to members; Underwriters' Laboratories, Inc. v. Commissioner, 135 F. 2d 371 (7<sup>th</sup> Cir.), cert. denied, 320 U.S. 756 (1943) – reports and studies furnished; Spokane Motorcycle Club v. United States, 222 F. Supp. 151 (E.D. Wash. 1963) – goods, services, and refreshments given. That the benefit conveyed may be relatively small does not change the basic fact of inurement. Spokane Motorcycle Club v. United States, supra.

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In *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), aff'd in unpublished opinion 647 F. 2d 170 (9<sup>th</sup> Cir. 1981) ("*est of Hawaii*"), several for-profit est organizations exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. The fact that amounts paid to the for-profit organizations under the contracts were reasonable did not affect the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in section 501(c)(3).

**Insider:**

In defining who is an insider, the court in United *Cancer Council, Inc. v. Commissioner*, 165 F. 3d 1173, 1176 (7<sup>th</sup> Cir. 19XX), stated: "The term "any private shareholder or individual" in the inurement clause of Section 501(c)(3) of the Internal Revenue Code has been interpreted to mean an insider of the charity. *Orange County Agricultural Society, Inc. v. Commissioner*, 893 F.2d 529, 534 (2d Cir. 1990); *Church of Scientology v. Commissioner, supra*, 823 F.2d at 1316-19; *Church by Mail, Inc. v. Commissioner*, 765 F.2d 1387, 1392 (9<sup>th</sup> Cir. 1985); American *Campaign Academy v. Commissioner*, 92 T.C. 1053, 1066 (1989). A charity is not to siphon its earnings to its founder, or the members of its board, or their families, or anyone else fairly to be described as an insider, that is, as the equivalent of an owner or manager. The test is functional. It looks to the reality of control rather than to the insider's place in a formal table of organization. The insider could be a "mere" employee-- or even a nominal outsider, such as a physician with hospital privileges in a charitable hospital, *Harding Hospital, Inc. v. United States*, 505 F. 2d 1068, 1078 (6<sup>th</sup> Cir. 1974)..."

**Books and Records:**

Internal Revenue Code (Code) Section 7602(a) provides the authority "to examine any books, papers, records, or other data which may be relevant or material" for the purpose of ascertaining the correctness of any return....

Regulation Section 1.6033-2(i)(2) provides that, "Every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (Section 501 and following), chapter 1 of subtitle A of the Code, Section 6033, and chapter 42 of subtitle D of the code."

Section 6001 of the code provides, "Notice or Regulation Requiring Records, Statements, and Special Returns" provides, in part: "Every person...shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe."

Regs. 1.501(c)(3)-1(d)(1)(ii) provides that the burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests.

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer  <b>ORG</b>	Tax Identification Number	Year/Period ended  December 31, 20XX

**LEGEND**

ORG = Organization name      XX = Date      Address = address      XYZ = State      Revenue Agent = revenue agent      BM1 thru BM10 = 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup>, 5<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup>, 8<sup>th</sup>, 9<sup>th</sup>, and 10<sup>th</sup> board members

Income Tax Regulation (Regulation) Section 1.274-5 addresses the substantiation requirements with respect to the business purpose of an expense. If the substantiation requirements are not met no deduction is allowed with respect to that expense.

Regulation Section 1.274-5T(b) identifies the elements that the taxpayer must substantiate with respect to the expenditure: (i) amount, (ii) time and place of travel, entertainment, amusement, recreation, or use of the facility or property, (iii) business purpose, and (iv) the business relationship to the taxpayer of each person entertained, using the facility or property, or receiving the gift. Section 1.274-5T(c) notes that a taxpayer must substantiate each element of an expenditure by adequate records or by sufficient evidence corroborating taxpayer's own statement. Section 274(d) contemplates that a taxpayer will maintain and produce such substantiation as will constitute clear proof of an expenditure referred to in Section 274. It states that a record of the elements of an expenditure made at or near the time of expenditure, supported by sufficient documentary evidence, has a high degree of credibility not present with respect to a statement prepared subsequent thereto when generally there is a lack of accurate recall. It states that the corroborative evidence required to support a statement not made at or near the time of the expenditure "must have a high degree of probative value to elevate such statement and evidence to the level of credibility reflected by a record made at or near the time of the expenditure supported by sufficient documentary evidence". It states that to obtain a deduction for travel, etc., a taxpayer must substantiate each element of the expenditure.

**Failure to File Form 990s:**

Section 6033(a)(1) of the Code provides, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Section 1.6001-1(a) of the regulations in conjunction with section 1.6001-1(c) provides that every organization exempt from tax under section 501(a) of the Code and subject to the tax imposed by section 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by section 6033.

Section 1.6001-1(e) of the regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

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 board members

Section 1.6033-1(h)(2) of the regulations provides that every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the district director for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of subchapter F (section 501 and the following), chapter 1 of the Code and section 6033.

*Rev. Rul. 59-95, 1959-1 C.B. 627*, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

In accordance with the above cited provisions of the Code and regulations under sections 6001 and 6033, organizations recognized as exempt from federal income tax must meet certain reporting requirements. These requirements relate to the filing of a complete and accurate annual information (an other required federal tax forms) and the retention of records sufficient to determine whether such entity is operated for the purposes for which it was granted tax exempt status and to determine its liability for any unrelated business income tax.

### **GOVERNMENT'S POSITION**

Based on the examination conducted, it has been concluded that ORG does not continue to qualify for tax-exempt status as an organization described in Section 501(c)(3) of the Code. Although ORG has engaged in regular and ongoing activities that further exempt further exempt purposes, it has engaged in a number of excess benefit transactions therefore jeopardizing its exemption.

BM-1 controls ORG's operation and financial affairs. He founded the organization, and he makes decisions for ORG. He also exerts substantial influence over the organization for purposes of the excess benefits under section 4958 of the Code.

The examination determined that ORG paid travel expenses on BM-1's behalf. ORG did not maintain any airline tickets, receipts, or correspondence confirming the business purpose of travel during 20XX. Additionally, ORG acknowledged that they do not have an accountable plan in place and travel did not have to be approved by the board of directors because they were board members in name only. Without evidence that the travel serves any kind of a charitable purpose, or that it was ordinary and necessary to carry out a charitable program, we can only conclude that any expense ORG incurs for the travel provides inurement to BM-1.

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board members

During the years under examination, BM-1 paid a series of expenses that were personal in nature using ORG's funds. These payments were not included as compensation on BM-1's 1040 nor were they reported on ORG's Form 990. In addition, there was no documented approval of the expenses by the board of directors. The diversions of ORG's funds to pay BM-1's personal expenses constituted excess benefit transactions between an applicable tax-exempt organization and a disqualified person under section 4958.

To summarize inurement, BM-1 benefited as follows:

20XX	Travel Expenses	
20XX	Personal Expenses	
	<b>Total Inurement</b>	

Since inurement and private benefit issues are highly fact dependent, the courts do not look with favor on an organization's failure to provide relevant facts and they are not hesitant to find that an organization has failed to carry its burden. See Gondia Corporation v. Commissioner, T.C. Memo. 1982-422; Schoger Foundation v. Commissioner, 76 T.C. 380 (1981); The Basic United Ministry of Alma Karl Schurig v. Commissioner, 670 F.2d 1210 (1982); First Libertarian Church v. Commissioner, 74 T.C. 396 (1980); Church of Gospel Ministry, Inc. v. U.S., 58 AFTR 2d 86-5232 (D.C. 1986); Universal Bible Church, Inc. v. Commissioner, T.C. Memo. 1986-170.

The Service has sufficient information to establish a pattern of control on the part of insiders has resulted in continuing inurement to the insiders. We believe that a correction under Internal Revenue Code Section 4958 would not be sufficient to allow ORG to retain its exempt status. Furthermore, it is expected that ORG will continue to be controlled by the same person.

ORG has engaged in regular and ongoing activities that further exempt purposes both before and after the excess benefit transactions occurred. However, the size and scope of the excess benefit transactions engaged in by ORG beginning in 20XX collectively are significant in relation to the size and scope of ORG's activities that further exempt purposes. Moreover, ORG has been involved in repeated excess benefit transactions. ORG has not implemented any safeguards that are reasonably calculated to prevent future diversions. The excess benefit transactions have not been corrected, nor has ORG made good faith effort to seek correction from BM-1, the disqualified person who benefited from the excess benefit transactions. Based on the application of the factors to these facts, ORG is no longer described in section 501(c)(3) effective January 1, 20XX.

**CONCLUSION**

Based on the above, we propose to revoke ORG's tax-exempt status. This proposed revocation would become effective January 1, 20XX. Any contributions to ORG are no longer deductible as charitable contributions. Any

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contributions to this organization by those who were in part responsible for or were aware of, the activities or deficiencies on the part of the organization that gave rise to loss of exempt status will not be allowed as a deduction effective the date of revocation.

ORG will be required to file Form 1120 for the tax period ending December 31, 20XX, and all subsequent tax periods.

If this proposed revocation becomes final, appropriate State officials will be advised of the action in accordance in Internal Revenue Code Section 6104(c) and applicable regulations.